

CREDIT OPINION

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New Issue

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Contacts

Lauren Von Bargaen 212-553-4491
 Analyst
 lauren.vonbargaen@moody's.com

Edward (Ted) 212-553-6990
 Damutz
 VP-Sr Credit Officer
 edward.damutz@moody's.com

Rockville (City of) MD

New Issue - Moody's Assigns Aaa to Rockville, MD's \$9.9M GO Bonds 2017A; Outlook Stable

Summary Rating Rationale

Moody's Investors Service has assigned a Aaa to the City of Rockville, MD's \$9.9 million General Obligation Bonds, Series 2017A. Moody's maintains a Aaa rating on the city's outstanding GO debt. The city's outlook is stable.

The Aaa rating reflects the city's sizable tax base, above average wealth levels, and the continued growth of the city's job base. The rating further considers the strong financial position, characterized by conservative fiscal management, ample reserve levels, long-term operating stability, and low fixed costs.

Credit Strengths

- » Sizable, diverse tax base in metro-DC area
- » Historically stable financial position bolstered by formal fiscal policies
- » Manageable fixed costs

Credit Challenges

- » Uncertain impact of future federal budget cuts on local economy

Rating Outlook

The outlook reflects the expectation that the city's financial position will remain sound given demonstrated trends of stability driven by conservative budgeting, fiscal monitoring and formal policies. The outlook also incorporates the city's large tax base that will continue to benefit from its position as an employment center in the metro-DC region.

Factors that Could Lead to an Upgrade

- » Not applicable

Factors that Could Lead to a Downgrade

- » Use of fund balance resulting in reserves below policy levels
- » Weakened financial position due to support of enterprise funds
- » Declines in tax base or weakened socioeconomic factors

Key Indicators

Exhibit 1

Rockville (City of) MD	2012	2013	2014	2015	2016
Economy/Tax Base					
Total Full Value (\$000)	\$ 11,756,261	\$ 11,746,204	\$ 11,861,673	\$ 11,954,831	\$ 12,448,410
Full Value Per Capita	\$ 192,852	\$ 189,058	\$ 187,087	\$ 185,833	\$ 184,969
Median Family Income (% of US Median)	179.2%	177.1%	176.6%	182.1%	182.1%
Finances					
Operating Revenue (\$000)	\$ 66,675	\$ 68,424	\$ 71,982	\$ 71,388	\$ 77,574
Fund Balance as a % of Revenues	20.0%	20.3%	22.3%	29.0%	28.6%
Cash Balance as a % of Revenues	8.0%	19.5%	14.0%	10.5%	15.7%
Debt/Pensions					
Net Direct Debt (\$000)	\$ 84,835	\$ 79,494	\$ 76,865	\$ 75,244	\$ 78,053
Net Direct Debt / Operating Revenues (x)	1.3x	1.2x	1.1x	1.1x	1.0x
Net Direct Debt / Full Value (%)	0.7%	0.7%	0.6%	0.6%	0.6%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	N/A	0.8x	0.8x	0.8x	0.8x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	N/A	0.5%	0.5%	0.5%	0.5%

Source: Moody's Investors Service

Detailed Rating Considerations

Economy and Tax Base: Large Tax Base Expected to Experience Ongoing Growth

Rockville's tax base is expected to experience moderate growth in the near term due to ongoing development. The city's strategic location in the metropolitan area is supported by a transportation network that includes two metrorail stations. The full valuation of the city's tax base has stabilized following three years of modest declines in fiscal years 2011 through 2013 due to the housing downturn, but has increased more recently to a sizable \$12.4 billion as of fiscal 2016, above the median for national Aaa-rated cities. The [State of Maryland](#) (Aaa stable) requires the appreciation of owner-occupied residential property to be phased-in over a multi-year period, capped at 10% annually, assuring steady annual growth in the city's residential tax base as pent up appreciation is added to the tax rolls. City officials estimate 5.6% growth in fiscal 2017 due to recent commercial development. Officials report several developments currently under construction, including Twinbrook Station, a 26-acre mixed-use development, and Upper Rock, a mixed-use community that is expected to be completed by 2020. Additionally, the Duball project, a residential, retail and hotel development was recently completed.

The city's residential population, estimated at 67,300 as of 2016, continues to be supported by the city's position as a regional employment center, with a diverse and broad job base that includes nearly 75,000 positions in bio-technology, research, health care, and engineering, among other sectors. The government sector represents another large source of employment, a reflection of the city's proximity to Washington and its role as the county seat of [Montgomery County](#) (Aaa stable). Unemployment, at 3% as of March 2017, is consistently below statewide unemployment levels. City wealth levels remain above state and national medians; full value per capita is a solid \$184,969. Moody's notes that while the city's proximity to the metro-D.C. area has been considered a strength and will likely remain so over the long term, current credit pressures on the [U.S. federal government](#) (Aaa stable) could present near to medium term vulnerabilities for the city.

Financial Operations and Reserves: Strong Financial Position Supported by Conservative Management

Rockville will maintain a solid financial position, given its history of operating stability, proactive management, conservative fiscal policies, and healthy reserve levels. Effective fiscal 2016, the city increased its formal unassigned fund balance policy to 20% of annual revenues from 15%. The city reported four consecutive operating surpluses, increasing reserves to \$23.8 million (30.7% of revenues) in fiscal 2016 from \$10.9 million (16.4% of revenues) in fiscal 2012. While General Fund balance is below the median for similarly rated

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credits, this is mitigated by stability in reserves, which benefit from formal policies, and operating flexibility. The city makes annual transfers to the capital projects fund for pay-go projects, including a \$7.6 million transfer in fiscal 2016, providing significant flexibility. Officials project a slight decrease in reserves in fiscal 2017 due to the use of \$2.7 million for capital projects.

The fiscal 2018 budget represents a 3.3% increase relative to the prior year. Budgetary growth is offset by property and income tax growth, without a property tax rate increase. The budget is balanced without the use of reserves.

The city's largest revenue sources are property taxes and income taxes, which accounted for 49.6% and 18.3% of fiscal 2016 revenues, respectively. Going forward, the city's financial position is expected to remain sound given conservative management and formal policies.

LIQUIDITY

The city's liquidity position is adequate, with \$12 million (15.4% of revenues) in cash in the General Fund as of fiscal 2016. The General Fund maintains receivables from the water (\$5.4 million) and sewer (\$8 million) funds, which accounts for the difference between the city's cash and reserve positions. The loans were used to prepay several capital projects and will be repaid over the next six years as recently adopted rate increases are implemented.

Debt and Pensions: Manageable Fixed Costs

The city's debt burden will remain manageable given anticipated steady tax base growth in the medium term. The city's direct debt burden is below average at 0.5% of full valuation, and the overall debt burden, including the overlapping debt of Montgomery County, is average at 2.1% of full valuation. Approximately 75% of the city's outstanding debt is attributable to enterprise funds (water, sewer, stormwater and parking). Moody's considers the water, sewer and stormwater debt to be self-supporting, as debt service coverage is greater than one, and is not included in the direct debt burden calculation; parking debt is not self-supporting. The city adopted a three year rate increase for the water and sewer system, effective fiscal 2016, which will continue to support adequate debt service coverage and improve the fund's liquidity position.

Debt service comprised approximately 7.7% of fiscal 2016 operating expenditures (this does not include all of the debt service in the enterprise funds). The fiscal 2018 budget includes a General Fund transfer of \$850,000 to service the debt obligations of the parking system; however, the city recently signed a long-term operating lease, which has reportedly improved operations and will likely result in fiscal independence in that fund over the medium-term. The city's five year, \$86 million capital improvement plan is expected to be largely funded from pay-go (54%) and bond proceeds (45%).

DEBT STRUCTURE

All debt is fixed rate. Payout is average, with 67.1% of all debt repaid in 10 years.

DEBT-RELATED DERIVATIVES

The city is not party to any derivative agreements.

PENSIONS AND OPEB

The city maintains a single-employer defined benefit plan, as well as a defined contribution plan. The city annually contributes 100% of the actuarial determined contribution (\$3.5 million in fiscal 2016). The city contributed \$660,000 to the defined contribution plan in fiscal 2016. In fiscal 2016, the city funded OPEB in excess of the ADC (\$618,000). Combined fixed costs (debt service, and defined benefit and OPEB ADCs) represents a manageable 13.1% of fiscal 2016 operating expenditures.

The city's combined adjusted net pension liability (ANPL), under Moody's methodology for adjusting reported pension data, is \$71.6 million, or approximately a moderate 0.92 times operating fund revenues. Moody's uses the adjusted net pension liability to improve comparability of reported pension liabilities. The adjustments are not intended to replace the city's reported liability information, but to improve comparability with other rated entities.

Management and Governance

The city's management team is experienced and utilizes formal policies to ensure financial stability. By formal policy, the city is required to maintain unassigned General Fund balance at a minimum 20% of annual revenues, and management aims to use fund equity above the policy requirement for capital projects and other one-time uses. Additionally, the city recently increased the liquidity target for the

water and sewer fund to six months of operating and maintenance expenses from three months, a metric that is expected to be met by fiscal 2021 for the water fund and 2023 for the sewer fund.

Maryland Counties have an Institutional Framework score of Aa, which is high compared to the nation. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. While the sector's largest revenue source, property taxes, is not subject to any statewide caps, income taxes account for approximately a third of revenues and are capped at 3.2%. Unpredictable revenue fluctuations tend to be minor, or under 5% annually. Across the sector, fixed and mandated costs are generally greater than 25% of expenditures. Maryland has public sector unions, which can limit the ability to cut expenditures. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

Legal Security

Bonds are secured by the city's unlimited ad valorem pledge.

Use of Proceeds

Proceeds from the Series 2017A bonds will fund various capital projects, including a renovation of the city's swim and fitness center and water and sewer projects.

Obligor Profile

The City of Rockville is located in Montgomery County, approximately 12 miles northwest of the [District of Columbia](#) (Aa1 stable) along the I-270 corridor. As of 2016, the city population was 67,300.

Methodology

The principal methodology used in this rating was US Local Government General Obligation Debt published in December 2016. Please see the Rating Methodologies page on www.moody's.com for a copy of this methodology.

Ratings

Exhibit 2

Rockville (City of) MD

Issue	Rating
General Obligation Bonds, Series 2017A	Aaa
Rating Type	Underlying LT
Sale Amount	\$9,910,000
Expected Sale Date	06/05/2017
Rating Description	General Obligation

Source: Moody's Investors Service

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Contacts

Lauren Von Bargen
Analyst
lauren.vonbargen@moody's.com

212-553-4491

Edward (Ted) Damutz
VP-Sr Credit Officer
edward.damutz@moody's.com

212-553-6990

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
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